

# **I N T R O D U C T O R Y S E C T I O N**



December 19, 2005

**TO THE CITIZENS, GOVERNOR AND MEMBERS OF THE IOWA GENERAL ASSEMBLY**

In accordance with Iowa Code Section 8A.502(8) we are pleased to submit the Comprehensive Annual Financial Report (CAFR) for the State of Iowa for the fiscal year ended June 30, 2005.

The report is presented in three sections as follows:

- The **Introductory Section** includes this transmittal letter, the Government Finance Officers Association (GFOA) Certificate of Achievement for the fiscal year 2004 CAFR, an organizational chart of State government, and a list of principal State officials.
- The **Financial Section** contains the independent auditor's report on the Basic Financial Statements, Management's Discussion and Analysis (MD&A), the Basic Financial Statements, and Notes to the Financial Statements. The Financial Section also contains Required Supplementary Information (RSI), other than the MD&A, and supplementary information in the form of combining financial statements and schedules. This letter is intended to be read in conjunction with the MD&A.
- The **Statistical Section** highlights selected financial and demographic information, generally presented on a multi-year basis.

The Department of Administrative Services is responsible for both the accuracy of the presented data, and the completeness and fairness of the presentation. We believe the information presented is accurate in all material respects and the necessary disclosures have been made which enable the reader to obtain an understanding of the State's financial activity.

This report has been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for governments as promulgated by the Governmental Accounting Standards Board (GASB).

As a part of the statewide accounting system upgrade during fiscal year 2005, the implementation team performed a comprehensive review of the adequacy of internal controls and budgetary controls of the system. The team determined that internal controls continue to be in place to provide reasonable, but not absolute, assurance that assets are safeguarded against unauthorized use or disposition, and that financial records from all appropriate sources are reliable for preparing financial statements and maintaining accountability. The concept of reasonable assurance recognizes the cost of internal controls should not exceed the benefits likely to be derived from their use. To monitor the adequacy of internal controls, the Auditor of State reviews internal control procedures as an integral part of departmental audits.

The Auditor of State is required by Chapter 11 of the Code of Iowa to audit annually all departments of the State. The accompanying basic financial statements of the State of Iowa have been audited by the Auditor of State in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. His report appears elsewhere herein.

In addition, the Auditor of State conducts a single audit under the requirements set forth in the Single Audit Act of 1984, the Single Audit Amendments of 1996, and OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations. This report is issued separately.

This letter of transmittal is designed to complement Management's Discussion and Analysis (MD&A), and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

## **PROFILE OF THE GOVERNMENT**

All activities that would generally be considered part of the State of Iowa are included in this report. These activities provide a range of services including education, health and human services, transportation, agriculture and natural resources, law enforcement, public safety, economic development, legislative, judicial, and administrative services.

This report includes all of the fund types, departments and agencies of the State, as well as boards, commissions, authorities, and universities for which the State's executive, legislative, and judicial branches are financially accountable. The criterion considered in establishing financial accountability, as set forth by the GASB include: appointing a voting majority of the organization's governing body, and either (1) the ability to impose its will on the organization or (2) the potential for the organization to provide specific financial benefits to, or impose financial burdens on the State. It also includes component units where the nature and significance of their relationship with the State are such that their exclusion would cause the financial statements to be misleading or incomplete. The reader is directed to Note 1.B in the Notes to the Financial Statements for a more complete description of the factors used to define the reporting entity.

**State Budget and Budgetary Controls.** The State's budget is prepared by the Governor on an annual basis and is required to be submitted along with proposed appropriation bills to the General Assembly by the first of February prior to the new fiscal year. When both houses of the General Assembly pass an appropriation bill, the bill is enrolled and sent to the Governor. The Governor may sign it into law or veto it in whole or in part on a line item basis. Funds may be disbursed only after the Department of Management, subject to the review of the Governor, has allotted appropriations, with the exception of standing unlimiteds and certain receipts that the Departments are authorized to expend.

Departments may request revisions to allotments, appropriations transfers, or supplemental appropriations. The Department of Management approves revised allotments within an appropriation, subject to the Governor's review. The Governor and the Department of Management approve all appropriation transfers. The General Assembly and the Governor act on supplemental appropriation bills in a manner similar to original appropriations. General Fund supplemental appropriations totaled \$87,013,573 for fiscal year 2005. Appropriations lapse at fiscal year-end and all unencumbered or unobligated balances revert to the state treasury, unless otherwise provided.

Budgetary controls are incorporated into State accounting systems. The annual budget of the State is established through separate appropriations to individual departments for specific purposes, special outlays and/or operating expenditures. Budgetary control is essentially maintained at the departmental level except for certain grant and aid programs where control is maintained at the program level.

The statewide accounting system performs various edits to assure appropriation authorizations are not exceeded. In addition to these centralized controls, each department director is required by statute to maintain expenditures within appropriated limits.

Extensive use is made of on-line tables and reports, updated on a daily basis, to provide detailed and management level reports to State departments, budget authorities, and the State Legislature. Departments also have the ability to extract selected information and prepare customized reports as needed. Detailed monthly reports are prepared to assure expenditures are being executed according to plan, deviations are identified and budget or spending modifications are made on a continuing basis.

## **ECONOMIC CONDITION AND OUTLOOK**

**Personal Income.** The University of Iowa Institute for Economic Research's latest outlook is for personal income in Iowa to grow by 5.2% in 2005, 4.9% in 2006, and 5.2% in 2007. According to the Bureau of Economic Analysis, in the last two quarters of 2004-05 fiscal year, Iowa's personal income, seasonally adjusted, grew at a rate of 0.9% and 1.3% respectively; which was close to the nation as a whole, with personal income growth of 0.6% and 1.5%.

Iowa's personal income for calendar year 2004 grew at the second highest rate in the nation, with Nevada the only state having a higher percentage of growth. Iowa's personal income grew at 8.9%, compared to the national average of 6.0%. Contributing to Iowa's personal income was higher growth in construction (10.5%), transportation and warehouse (8.3%), finance and insurance (7.9%), manufacturing (6.7%), health care and social assistance (6.4%) and higher farm income.

**Employment.** Iowa continues to have an average unemployment rate below the rate of the nation as a whole. Over the past 10 years, Iowa's unemployment rate has been between one and two percentage points below the national average. The U.S. unemployment rate for October 2005 was 4.5%, compared to 5.5% in October 2004. The seasonally adjusted percent unemployed for the State in October 2005 was 4.5%, compared to 5.0% in October 2004. The October 2005 unemployment rate decreased 0.1% from September 2005.

In October 2005, there were 1,577,300 employed Iowans. This compares with the record level of 1,630,500 employed Iowans in September 2002.

**Exports.** The rise in exporting industries has been an important factor in Iowa economic growth since the 1990's. Growth in exports of industrial machinery, instruments and measurement devices, electronics, specialized transportation equipment, chemicals and pharmaceuticals, and processed food products have helped diversify Iowa's economy. When combined with traditional farm commodities and livestock, total exports from Iowa increased by 22%, 11% and 13% in the years 1995 through 1997. A combination of factors contributed to declines of 3% and 16% in 1998 and 1999.

Subsequent years have seen steady and strong growth. Iowa's export of value-added and manufacturing goods has increased since 2000 by 4.4% in 2001, 2.0% in 2002, 10.1% in 2003 and 22.1% in 2004. Canada continues to be Iowa's largest trading partner, followed by Mexico and Japan. In 2003 and 2004, Mexico replaced Japan as the second leading export country, partially due to the increase of value-added products shipped to Mexico.

Iowa's record level of exports has been fueled by large percentage increases in machinery, electrical machinery, cereals, milling and organic chemicals. Overall, for the second quarter 2005, exports are up 16.1%.

**Gross State Product.** In 2004, Iowa's gross state product was \$111.1 billion, which reflected 8.5% growth over the previous year. The largest shares of the Iowa gross state product were manufacturing (20.6%), services (11.3%), and finance, insurance, and real estate (10.7%). Agriculture accounted for just 4.6% of Iowa's gross state product. The gross state product is the U.S. Commerce Department's measure of the value of all goods and services produced in the State each year. The nation's gross domestic product (\$11.7 trillion) grew by 4.3% between 2003 and 2004.

**Farmland Values.** The most recent survey of area bankers indicates that farmland values continue to rise. The Federal Reserve Bank of Chicago surveys farm bankers in the area four times a year to determine their best estimates of farmland values. In their July 2005 survey, Iowa farmland values had risen 11% compared to the 2004 survey. Gains were registered throughout each region in the State, with the South Central region growing the most (17%), and the West region showing the smallest increase (8%). In their July 2004 survey, Iowa farmland values had risen 12% compared to the July 2003 survey. The 2003, 2002, 2001 surveys showed increases of 7%, 7%, and 2% respectively.

## **MAJOR INITIATIVES AND ISSUES**

**Grow Iowa Values Fund.** During the 2003 session, the Legislature adopted Governor Vilsack's recommendation that the State make a significant new investment in economic development. The Grow Iowa Values Fund was created to invest \$503 million in five key areas with the goal of creating 50,000 quality, good paying jobs in the next four years. These investments will be made in four key areas: business development and assistance, university research and development, workforce training, and quality of life.

The Legislature appropriated \$59 million in fiscal year 2004 and \$41 million in fiscal year 2005 to the Grow Iowa Values Fund. These were made from the entirety of the State of Iowa's allocation of federal flexible spending grant money appropriated by Congress in June, 2004. The Legislature also made contingent appropriations of \$5.0 million in FY 2004, \$23.0 million in FY 2005, and \$75.0 million a year in FY 2006 through FY 2010. These appropriations are contingent on sales and use tax receipts growing by more than 2.0% in each of the respective fiscal years.

However, on June 16, 2004, the Iowa Supreme Court ruled that the legislation creating the Grow Iowa Values Fund was invalid. Because the State had already entered into contracts for several projects, the State Appeal Board on August 27, 2004 approved claims totaling \$10,749,754 to cover these contractual obligations.

On September 7, 2004, the general assembly met in special session and approved HF 2581 and SF 2311, which were signed by the Governor. Among other things, these bills created the Federal Economic Stimulus and Jobs Holding Fund and deposited the proceeds from the 2003 Federal Jobs and Growth Tax Relief Reconciliation Act into the Fund. SF 2311 also appropriated a total of \$100.0 million from the Fund to economic development programs previously funded by the Grow Iowa Values Fund.

The original Grow Iowa Values Fund appropriations were repealed by SF 2311. These appropriations totaled \$277.5 million over a four-year period from fiscal year 2004 to fiscal year 2007.

During the 2005 session, for FY 2006, the Legislature appropriated a total of \$500.0 million over 10 years from the General Fund to a reconstituted Grow Iowa Values Fund. \$50.0 million per year is appropriated from the Fund for economic development purposes.

**Class Size Reduction and Intervention.** During fiscal year 2005, \$30.0 million was appropriated to local school districts to reduce class sizes in kindergarten through the third grade, with the goal of achieving average class sizes of 17 students per teacher. This flexible initiative also allows school districts to use funding to support other proven methods to improve reading and other basic skills for elementary school students.

These and other educational efforts have allowed Iowa to reverse a decade-long decline in student test scores. Reading proficiency improved at the 4<sup>th</sup>, 8<sup>th</sup>, and 11<sup>th</sup> grade levels, and math proficiency improved at the 4<sup>th</sup> and 11<sup>th</sup> grade levels.

**Teachers' Compensation.** During a previous legislative session, a bill was passed and signed by the Governor establishing the Student Achievement and Teacher Quality Program. This multi-year program includes statewide mentoring, a new career path compensation strategy, redesigned professional development and new Iowa Teaching Standards which begin to define good teaching for purposes of evaluation and professional development. In fiscal year 2005, \$45.3 million was appropriated to continue this program.

**Local Early Childhood Initiatives.** Early learning is critical to success in school, and Iowa's community empowerment initiative allows local governments and service providers a flexible method to tailor local services to meet local needs. Originally funded in fiscal year 1998 at \$5.4 million, the level of funding has increased, and in fiscal year 2005, the funding from the General Fund and other funds totaled \$26.8 million. The additional funding is targeted at children from birth to age 5 and to parent education initiatives.

## FINANCIAL INFORMATION

**Cash Management.** The cash management function is the responsibility of the State Treasurer. Funds of State agencies, which are temporarily available for investment, are pooled together and invested in certificates of deposit, U.S. Treasury bills and notes, U.S. Government Agency and instrumentality obligations, repurchase agreements, and corporate debt instruments as allowed by law and the Treasurer's investment policy. The three goals of the investment policy, in order of importance, are 1) safety of funds; 2) liquidity; and 3) return. A custodial bank is utilized to safekeep investments and to provide payment and collection services for investment transactions. All investment transactions occur on a payment versus delivery basis. It is the policy of the Treasurer's Office that all deposits under its control are insured or collateralized in accordance with Chapter 12C of the Iowa Code.

Presented below is comparative data for the State's investment pool for the last four fiscal years. Interest Earnings do not include any unrealized gains or losses on investments. The Annual Rates of Return shown are calculated by dividing Interest Earnings by the Pool Average Daily Investment Balance. The amounts below are expressed in thousands:

	FY05	FY04	FY03	FY02
Interest Earnings*	\$ 47,567	\$ 32,709	\$ 38,834	\$ 74,444
Average Daily Investment Balance	\$ 1,788,237	\$ 1,540,147	\$ 1,373,979	\$ 1,500,726
Annual Rate of Return	2.66%	2.12%	2.83%	4.96%

\* Safekeeping and banking expenses have been deducted from Interest Earnings.

**Debt Administration.** The Constitution of the State of Iowa prohibits the State from exceeding a maximum of \$250 thousand in general obligation debt without voter approval. However, State law authorizes the issuance of Tax and Revenue Anticipation Notes (TRANS), provided that the total issuance does not exceed anticipated revenue receipts for the fiscal year and that the total issuance matures during the fiscal year. The State issued and repaid Tax and Revenue Anticipation Notes of \$375.0 million during fiscal year 2005.

Revenue bonds issued by various authorities of the State totaled \$2,590.0 million outstanding at fiscal year-end. This amount consisted of \$866.4 million of component unit – proprietary funds revenue bonds (housing and higher education), \$757.8 million in revenue bonds issued by the three State universities and Iowa Lottery Authority (for equipment & facilities), \$627.9 million in revenue bonds issued by the Tobacco Settlement Authority and \$337.8 million in various bonds issued by the Iowa Finance Authority for the Vision Iowa Program, the School Infrastructure Loan Program, the Underground Storage Tank Program, and the Department of Corrections. These bonds are backed by the revenues of the issuing program or authority.

Certificates of Participation (COPS), issued by the State and outstanding at fiscal year-end, amounted to \$2.0 million. COPS represent an ownership interest of the certificate holder in a lease purchase agreement.

The State has also entered into capital leases and other financing agreements for various purposes. Total long-term capital leases and other financing agreements outstanding on June 30, 2005, was \$135.9 million.

**Pension Trust Funds.** The latest actuarial valuations of the separately funded and independent pension plans disclose the following information: the Iowa Public Employees Retirement System (IPERS) has an Unfunded Actuarial Accrued Liability (UAAL) of \$2,288.6 million which represents a funding ratio of 88.69%; the Peace Officers' Accident and Disability System (PORS) has an UAAL of \$91.3 million which represents a funded ratio of 73.39%; and the Judicial Retirement System (JRS) has a UAAL of \$23.9 million which represents a funded ratio of 77.37%. Schedules of Funding Progress for PORS and JRS are presented in the Required Supplementary Information Section. The funding policies of the Pension Trust funds are discussed in detail in the Notes to the Financial Statements (NOTE 16 - PENSION PLANS).

**Risk Management.** It is the policy of the State not to purchase commercial insurance, with the exception of limited third-party coverage for specific potential losses, for the risks of losses to which it is exposed. Instead, the State's management believes that it is more economical to manage its risks internally and set aside assets for claim settlement in its internal service funds or to pay claims from the General Fund. The State is self-insured for risks related to property and casualty, workers' compensation, and general liability. For further information refer to the Notes to the Financial Statements (NOTE 19 – RISK MANAGEMENT).

## OTHER INFORMATION

**Certificate of Achievement** – The Government Finance Officers Association of the United States and Canada (GFOA) awarded a “Certificate of Achievement for Excellence in Financial Reporting” to the State of Iowa for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. Such reports must satisfy both U.S. generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. This is the twelfth consecutive year the State of Iowa has received this award. We believe our current report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to the GFOA. We are committed to continue this effort, and we intend to maintain a highly qualified and professional staff to make this certification possible.

**Acknowledgment.** The preparation of this report on a timely basis requires the collective efforts of numerous finance personnel throughout the State and is made possible only with the cooperation and support of the Executive, Legislative, and Judicial branch agencies, universities, and component units of the State.

The report could not have been accomplished without the professionalism and dedication of the staff in the Department of Management, the State Accounting Enterprise within Administrative Services, the Auditor of State’s Office, and the financial and management personnel throughout State government.

This report, issued for the seventeenth consecutive year, continues our commitment to the citizens of the State of Iowa, the Governor, the Legislature, and the financial community, to maintain our financial statements in conformance with the highest standards of financial accountability.

Respectfully submitted,

Mollie K. Anderson, Director  
Department of Administrative Services

Michael L. Tramontina, Director  
Department of Management



# Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Iowa

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



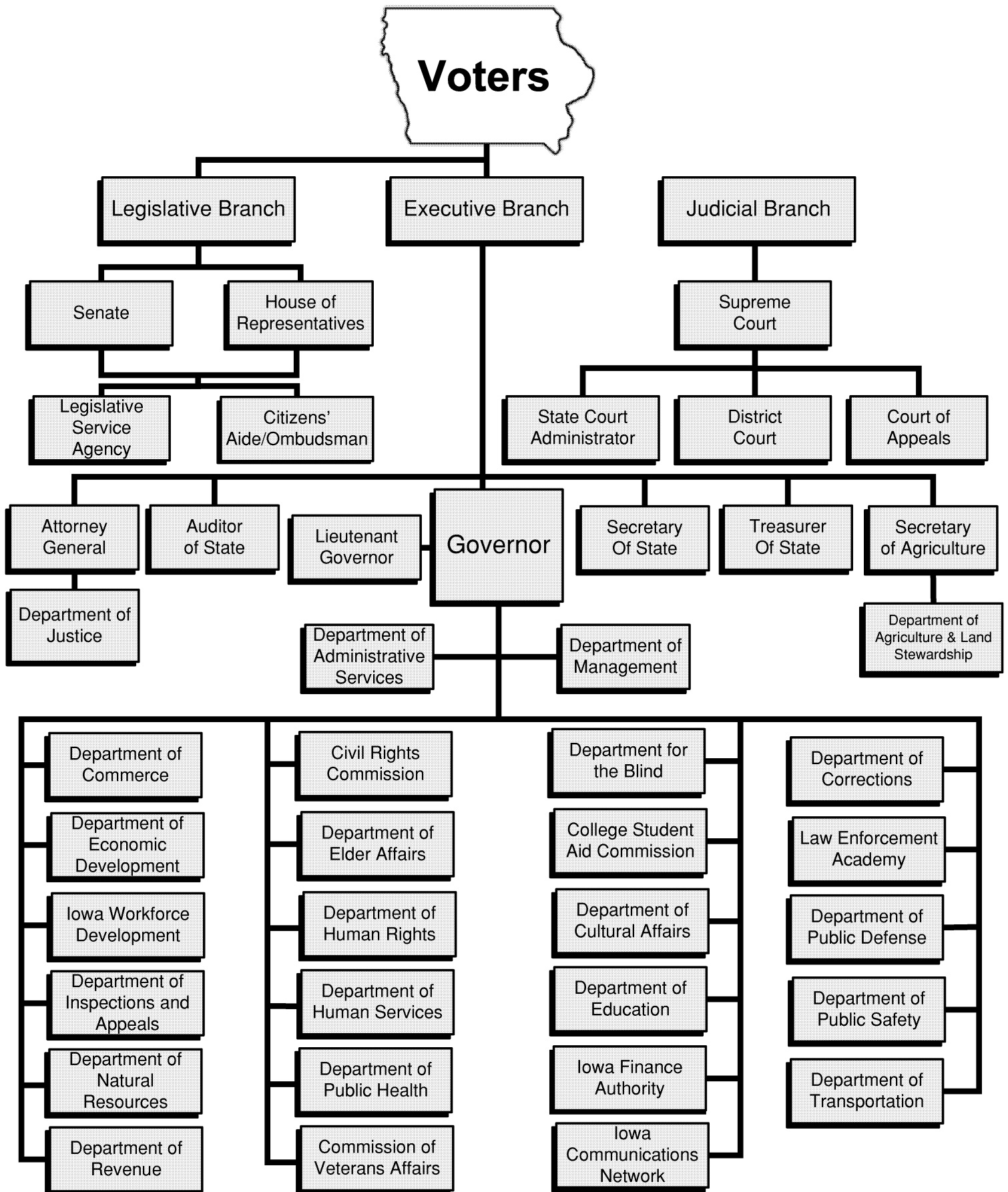
*Nancy L. Ziehl*

President

*Jeffrey R. Enos*

Executive Director

# State of Iowa Organizational Chart



P R I N C I P A L O F F I C I A L S

**Elected Officials**

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GOVERNOR - **Thomas J. Vilsack**  
LIEUTENANT GOVERNOR - **Sally J. Pederson**  
SECRETARY OF STATE - **Chester J. Culver**  
AUDITOR OF STATE - **David A. Vaudt**  
TREASURER OF STATE - **Michael L. Fitzgerald**  
SECRETARY OF AGRICULTURE - **Patty J. Judge**  
ATTORNEY GENERAL - **Thomas J. Miller**

**Legislative Branch**

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CO-PRESIDENTS OF THE SENATE - **John P. Kibbie**  
**Jeff M. Lamberti**  
SPEAKER OF THE  
HOUSE OF REPRESENTATIVES - **Christopher C. Rants**

**Judicial Branch**

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CHIEF JUSTICE OF  
THE SUPREME COURT - **Louis A. Lavorato**